Financial Section

for Fiscal Year ending June 30, 2008

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Board of Trustees
Teachers' Retirement System of the State of Kentucky
Frankfort, Kentucky

We have audited the accompanying statements of plan net assets of the Teachers' Retirement System of the State of Kentucky as of June 30, 2008 and 2007 and the related statements of changes in plan net assets for the years then ended. These component unit financial statements are the responsibility of the Teachers' Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the plan net assets of the Teachers' Retirement System of the State of Kentucky, a component unit of the Commonwealth of Kentucky, at June 30, 2008 and 2007 and the changes in its plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated December 11, 2008 on our consideration of the Teachers' Retirement System of the State of Kentucky's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages 15-19 are not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

The financial section supporting schedules listed in the table-of-contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. These schedules are the responsibility of the System's management. Such schedules as of and for the year ended June 30, 2008 have been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

We did not audit the data included in the Introductory and Statistical sections of the report and therefore express no opinion on them.

Charles T. Mitchell Co.

Frankfort, Kentucky
December 11, 2008

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis of Kentucky Teachers' Retirement System's financial performance provides an overview of the defined benefit and medical insurance plans' financial year ended June 30, 2008. Please read it in conjunction with the respective financial statements, which begin on page 20.

USING THIS FINANCIAL REPORT

Because of the long-term nature of a defined benefit pension plan, and the medical and life insurance plans, financial statements alone cannot provide sufficient information to properly reflect the plan's ongoing plan perspective. The Statement of Plan Net Assets and Statement of Changes in Plan Net Assets (on pages 20-23) provide information about the activities of the defined benefit plan, medical insurance plan, life insurance plan and the tax-sheltered annuity plan as a whole. The Kentucky Teachers' Retirement System is the fiduciary of funds held in trust for its members.

The Schedule of Funding Progress (on pages 45-46) includes historical trend information about the actuarially funded status of each plan from a long-term, ongoing plan perspective and the progress made in accumulating sufficient assets to pay benefits and insurance premiums when due. The Schedule of Employer Contributions (on pages 45-47) presents historical trend information about the annual required contributions of employers and the contributions made by employers in relation to the requirement. These schedules provide information that contributes to understanding the changes over time in the funded status of the plans.

KENTUCKY TEACHERS' RETIREMENT SYSTEM AS A WHOLE

In the fiscal year ended June 30, 2008, Kentucky Teachers' Retirement System's combined plan net assets decreased by $1,293.1 million – from $15,633.8 million to $14,340.7 million. The following summaries focus on plan net assets and changes in plan net assets of Kentucky Teachers' Retirement System's defined benefit plan, medical insurance plan, life insurance plan and the tax-sheltered annuity plan.

Summary of
Plan Net Assets
(In Millions)

Categories	Defined Benefit Plan 2008	Defined Benefit Plan 2007	Defined Benefit Plan 2006	Medical Insurance Plan 2008	Medical Insurance Plan 2007	Medical Insurance Plan 2006	Life Insurance Fund** 2008	Life Insurance Fund** 2007
Cash & Investments	$ 14,224.0	$ 16,204.5	$ 14,632.5	$ 182.0	$ 137.0	$ 132.1	$ 76.8	$ 69.1
Receivables	93.6	95.8	94.7	6.2	5.7	7.1	.8	.8
Capital Assets	3.0	3.1	3.2					
Total Assets	14,320.6	16,303.4	14,730.4	188.2	142.7	139.2	77.6	69.9
Total Liabilities	(243.9)	(880.8)	(879.0)	(2.3)	(1.9)	(7.6)		
Plan Net Assets	$ 14,076.7	$ 15,422.6	$ 13,851.4	$ 185.9	$ 140.8	$ 131.6	$ 77.6	$ 69.9

*TOTALS	2008	2007	2006
Cash & Investments	$ 14,482.8	$ 16,410.6	$ 14,764.6
Receivables	100.6	102.3	101.8
Capital Assets	3.0	3.1	3.2
Total Assets	14,586.4	16,516.0	14,869.6
Total Liabilities	(246.2)	(882.7)	(886.6)
Plan Net Assets	$ 14,340.2	$ 15,633.3	$ 13,983.0

* *The 403(b) Tax Shelter Plan cash and investments were approximately $.5 million for the years ended 2008 and 2007 and 2006.*

** *Separate amounts for the 2006 Life Insurance Fund are unavailable.*

Plan net assets of the defined benefit plan decreased by 8.72% ($14,076.7 million compared to $15,422.6 million). The decrease is primarily due to unfavorable market conditions which resulted in a net investment decrease of $909.1 million. The defined benefit plan assets are restricted to providing monthly retirement allowances to members and their beneficiaries.

Plan net assets of the medical insurance plan increased by 32% ($185.9 million compared to $140.8 million) primarily due to state allocations from redirecting contributions from the retirement fund to the medical plan. Plan assets are restricted to providing hospital and medical insurance benefits to members and their spouses.

Summary of Changes in Plan Net Assets
(In Millions)

Categories	Defined Benefit Plan 2008	2007	2006	Medical Insurance Plan 2008	2007	2006	Life Insurance Plan* 2008	2007
ADDITIONS								
Member Contributions	$ 291.4	$ 269.7	$ 258.5	$ 55.4	$ 53.1	$ 51.7	$	$
Employer Contributions	466.2	434.9	410.9	148.9	113.2	89.3	5.4	5.0
Net Investment Income	(909.1)	2,063.9	717.3	8.1	6.7	6.8	6.3	(3.4)
Other Income				11.9	10.4	6.1		
TOTAL ADDITIONS	$ (151.5)	$ 2,768.5	$ 1,386.7	$ 224.3	$183.4	$153.9	$ 11.7	$ 1.6
DEDUCTIONS								
Benefit Payments	$ 1,170.9	$ 1,102.6	$ 1,035.6	$	$	$	$ 4.0	$ 4.2
Refunds	15.9	14.8	12.9					
Administrative Expense	7.6	7.4	6.8					
Insurance Expenses				179.2	174.2	169.6		
TOTAL DEDUCTIONS	1,194.4	1,124.8	1,055.3	179.2	174.2	169.6	4.0	4.2
Increase (Decrease) in Plan Net Assets	**$ (1,345.9)**	**$ 1,643.7**	**$ 331.4**	**$ 45.1**	**$ 9.2**	**$ (15.7)**	**$ 7.7**	**$ (2.6)**

TOTALS	2008	2007	2006
ADDITIONS			
Member Contributions	$ 346.8	$ 322.8	$ 310.2
Employer Contributions	620.5	553.1	500.2
Net Investment Income	(894.7)	2,067.2	724.1
Other Income	11.9	10.4	6.1
TOTAL ADDITIONS	$ 84.5	$ 2,953.5	$ 1,540.6
DEDUCTIONS			
Benefit Payments	$ 1,174.9	$ 1,106.8	$ 1,035.6
Refunds	15.9	14.8	12.9
Administrative Expense	7.6	7.4	6.8
Insurance Expenses	179.2	174.2	169.6
TOTAL DEDUCTIONS	1,377.6	1,303.2	1,224.9
Increase (Decrease) in Plan Net Assets	**$ (1,293.1)**	**$ 1,650.3**	**$ 315.7**

* *Separate amounts for the 2006 Life Insurance Fund are unavailable.*

DEFINED BENEFIT PLAN ACTIVITIES

Member contributions increased $21.7 million. Retirement contributions are calculated by applying a percentage factor to salary and are paid monthly by each member. Members may also pay contributions to repurchase previously refunded service credit or to purchase various types of elective service credit.

Employer contributions totaled $466.2 million, a net increase of $26.3 million over the 2007 fiscal year.

The System experienced a decrease in net investment income compared to the increase of the previous year (negative $909.1 million at June 30, 2008 as compared to a $2,060.5 million increase at June 30, 2007). The decrease in the fair value of investments is mainly due to unfavorable market conditions for the year ended June 30, 2008. This can be illustrated as follows:

(In Millions)	2008	2007	2006
Appreciation (depreciation) in fair value of investments – June 30, prior year	$ 1,904.0	$ 690.4	$ 610.4
Appreciation (depreciation) in fair value of investments – June 30, end of year	385.4	1,904.0	690.4
Change in net appreciation (depreciation) in fair value of investments	(1,518.6)	1,213.6	80.0
Net income (net of investment expense)	426.9	443.1	434.8
Net gain on sale of investments	182.6	403.8	202.5
Investment Income (net) – June 30, end of year	$ (909.1)	$ 2,060.5	$ 717.3

Program deductions in 2008 increased $65.5 million. The increase was caused principally by an increase of $64.2 million in benefit payments. Members who were drawing benefits as of June 2008 received an increase of 2.1% to their retirement allowances in July 2007. Also, there was an increase of 1,233 members and beneficiaries on the retired payroll as of June 30, 2008.

OTHER POST EMPLOYMENT BENEFIT ACTIVITIES

During the 2008 fiscal year, member contributions increased $2.3 million and employer contributions increased by $35.7 million over fiscal year 2007. The employer contributions increased primarily because $125 million in stabilization funding was placed in the medical insurance fund from the pension fund at the recommendation of the System's actuary. The amount will be repaid over a ten-year period per KRS 161.553.

Program deductions increased $5.1 million due to an increase of insurance expenses of $5.1 million. The monthly premium subsidy for retirees under age 65 increased 5.80% from fiscal year 2007 to fiscal year 2008. A 17.56% increase is slated for calendar year 2009. The monthly premium subsidy for retirees age 65 and over decreased by 1.80% from fiscal year 2007 to fiscal year 2008.

Net investment income increased $1.4 million from $6.7 million in 2007 to $8.1 million in 2008. This is due to the recognition of interest income since all investments for the Medical Insurance Plan are short term in nature and the recognition of appreciation in fair value is not feasible. This can be illustrated as follows:

(In Millions)	2008	2007	2006
Appreciation in fair value of investments – June 30, prior year	$ 0	$ 0	$ 0
Appreciation in fair value of investments – June 30 end of year	0	0	0
Net appreciation in fair value of investments	0	0	0
Net income (net of investment expense)	8.1	6.7	6.8
Net gain on sale of investments	0	0	0
Investment Income (net) – June 30	$ 8.1	$ 6.7	$ 6.8

Starting this year, the life insurance plan is being displayed separately due to the actuary conducting a valuation independently from the defined benefit plan. The 2007 financial statements have been restated for comparative purposes. Total life insurance benefits paid for 2008 and 2007 were $4.0 and $4.2 million respectively.

HISTORICAL TRENDS

Accounting standards require that the Statement of Plan Net Assets state asset value at fair value and include only benefits and refunds due plan members and beneficiaries and accrued investment and administrative expenses as of the reporting date. Information regarding the actuarial funding status of the defined benefit plan, the medical insurance plan, and the life insurance plan is provided in the Schedule of Funding Progress (beginning on page 45). The asset value, stated in the Schedule of Funding Progress, is determined by the System's independent actuary. The actuarial accrued liability is calculated using the projected unit credit cost method.

The 2008 fiscal year reveals a decline in funding position of the pension plan due to an increase in the actuarial liability.

Annual required employer contributions of the defined benefit plan are provided in the Schedule of Employer Contributions (on page 45). This schedule indicates that for year 2008 employer shortfall of contributions created a net pension obligation of $250,170,583.

The medical insurance plan is not as vulnerable to adverse market conditions since its assets are all short term in nature and less likely to experience huge fluctuations. Although the plan continues to have a large unfunded actuarial liability, the current obligations are being met by current funding.

Annual required contributions of the Medical Insurance Plan are provided in the Schedule of Employer Contributions (on page 46). This schedule indicates that for year 2008 employer shortfall of contributions created a net OPEB obligation of $234,415,955.

Statement of Plan Net Assets
As of June 30, 2008

	Defined Benefit Plan	403(b) Tax Shelter	Medical Insurance Plan	Life Insurance Plan	2008 TOTAL
ASSETS					
Cash	$ 8,083,548	$	$	$ 587,853	$ 8,671,401
Prepaid Expenses	146,008		121,000		267,008
Receivables					
Contributions	29,761,242		2,273,890	60,048	32,095,180
State of Kentucky	500,956				500,956
Investment Income	62,223,633	29		736,866	62,960,528
Installment Account Receivable	661,499				661,499
Medicare D Receivables			3,901,214		3,901,214
Other Receivables	423,332				423,332
Total Receivables	93,570,662	29	6,175,104	796,914	100,542,709
Investments at Fair Value (See Note 5)					
Short Term Investments	201,290,978	498,892	181,882,630	5,100,000	388,772,500
Bonds and Mortgages	4,208,000,818			71,173,450	4,279,174,268
Equities	9,029,380,841				9,029,380,841
Alternative Investments	104,787,575				104,787,575
Real Estate	431,693,774				431,693,774
Total Investments	13,975,153,986	498,892	181,882,630	76,273,450	14,233,808,958
Invested Security Lending Collateral	240,638,736				240,638,736
Capital Assets, at cost net of accumulated depreciation of $1,978,998 (See Note 2)	3,018,126				3,018,126
Total Assets	14,320,611,066	498,921	188,178,734	77,658,217	14,586,946,938
LIABILITIES					
Liabilities					
Accounts Payable	2,618,197				2,618,197
Treasurer's Unredeemed Checks	3,518			14	3,532
Insurance Claims Payable			2,289,841		2,289,841
Compensated Absences Payable	658,434				658,434
Revenues Collected in Advance			5,670		5,670
Obligations under Securities Lending	240,638,736				240,638,736
Total Liabilities	243,918,885	0	2,295,511	14	246,214,410
NET ASSETS HELD IN TRUST FOR PENSION AND OTHER POST EMPLOYMENT BENEFITS: (See Required Supplemental Schedule 1 for a schedule of funding progress)	$ 14,076,692,181	$ 498,921	$ 185,883,223	$ 77,658,203	$ 14,340,732,528

The accompanying notes are an integral part of these financial statements.

Statement of Plan Net Assets
As of June 30, 2007

	Defined Benefit Plan	403(b) Tax Shelter	Medical Insurance Plan	Life Insurance Plan	2007 TOTAL
ASSETS					
Cash	$ 4,658,755	$	$	$ 729,147	$ 5,387,902
Prepaid Expenses	86,043		121,000		207,043
Receivables					
Contributions	29,217,090		2,240,981	58,822	31,516,893
State of Kentucky	956,905				956,905
Investment Income	64,796,686	2,233		762,605	65,561,524
Installment Account Receivable	777,938				777,938
Medicare D Receivables			3,487,197		3,487,197
Other Receivables					
Total Receivables	95,748,619	2,233	5,728,178	821,427	102,300,457
Investments at Fair Value (See Note 5)					
Short Term Investments	422,060,871	509,798	136,896,316	6,990,900	566,457,885
Bonds and Mortgages	4,408,820,024			61,387,003	4,470,207,027
Common Stock	10,114,620,014				10,114,620,014
Private Equity	5,074,147				5,074,147
Real Estate	381,693,796				381,693,796
Total Investments	15,332,268,852	509,798	136,896,316	68,377,903	15,538,052,869
Invested Security Lending Collateral	867,562,185				867,562,185
Capital Assets, at cost net of accumulated depreciation of $1,871,494 (See Note 2)	3,085,129				3,085,129
Total Assets	16,303,409,583	512,031	142,745,494	69,928,477	16,516,595,585
LIABILITIES					
Accounts Payable	2,819,398				2,819,398
Treasurer's Unredeemed Checks	2,203			14	2,217
Insurance Claims Payable			1,966,148		1,966,148
Compensated Absences Payable	636,201				636,201
Revenues Collected in Advance	9,799,500		7,112		9,806,612
Obligations under Securities Lending	867,562,185				867,562,185
Total Liabilities	880,819,487	0	1,973,260	14	882,792,761
NET ASSETS HELD IN TRUST FOR PENSION AND OTHER POSTEMPLOYMENT BENEFITS:	$15,422,590,096	$ 512,031	$ 140,772,234	$ 69,928,463	$ 15,633,802,824

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Plan Net Assets
As of June 30, 2008

	Defined Benefit Plan	403(b) Tax Shelter	Medical Insurance Plan	Life Insurance Plan	2008 TOTAL
ADDITIONS					
Contributions					
Employer	$ 466,247,782	$	$ 148,929,322	$ 5,411,249	$ 620,588,353
Member	291,423,948		55,402,830		346,826,778
Total Contribution	757,671,730		204,332,152	5,411,249	967,415,131
Other Income					
Recovery Income			25,322		25,322
Medicare D Receipts			11,911,565		11,911,565
Total Other Income			11,936,887		11,936,887
Investment Income					
Net Appreciation/(Depreciation) in Fair Value of Investments	(1,335,940,216)			2,821,989	(1,333,118,227)
Interest	240,681,166	17,397	8,128,179	3,499,502	252,326,244
Dividends	165,542,769				165,542,769
Rental Income, Net	28,660,581				28,660,581
Securities Lending, Gross Earnings	21,398,859				21,398,859
Gross Investment Income	(879,656,841)	17,397	8,128,179	6,321,491	(865,189,774)
Less Investment Expense	(9,499,832)				(9,499,832)
Less Securities Lending Expense	(19,926,852)				(19,926,852)
Net Investment Income	(909,083,525)	17,397	8,128,179	6,321,491	(894,616,458)
Total Additions	(151,411,795)	17,397	224,397,218	11,732,740	84,735,560
DEDUCTIONS					
Benefits	1,170,969,101	30,507		4,003,000	1,175,002,608
Refunds of Contributions	15,965,083		10,014		15,975,097
Insurance Expenses			179,276,215		179,276,215
Administrative Expense	7,551,936				7,551,936
Total Deductions	1,194,486,120	30,507	179,286,229	4,003,000	1,377,805,856
Net Increase (Decrease)	(1,345,897,915)	(13,110)	45,110,989	7,729,740	(1,293,070,296)
NET ASSETS HELD IN TRUST FOR PENSION AND OTHER POSTEMPLOYMENT BENEFITS:					
Beginning of year	15,422,590,096	512,031	140,772,234	69,928,463	15,633,802,824
Ending of year	$ 14,076,692,181	$ 498,921	$ 185,883,223	$ 77,658,203	$ 14,340,732,528

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Plan Net Assets
As of June 30, 2007

	Defined Benefit Plan	403(b) Tax Shelter	Medical Insurance Plan	Life Insurance Plan	2007 TOTAL
ADDITIONS					
Contributions					
Employer	$ 434,890,469	$	$ 113,233,784	$ 5,022,137	$ 553,146,390
Member	269,687,864		53,099,678		322,787,542
Total Contribution	704,578,333		166,333,462	5,022,137	875,933,932
Other Income					
Recovery Income			24,977		24,977
Medicare D Receipts			10,312,361		10,312,361
Total Other Income			10,337,338		10,337,338
Investment Income					
Net Appreciation/(Depreciation) in Fair Value of Investments	1,623,818,334			(6,481,274)	1,617,337,060
Interest	251,858,168	28,919	6,722,080	3,067,737	261,676,904
Dividends	165,183,866				165,183,866
Rental Income, Net	30,344,247				30,344,247
Securities Lending, Gross Earnings	52,672,196				52,672,196
Gross Investment Income	2,123,876,811	28,919	6,722,080	(3,413,537)	2,127,214,273
Less Investment Expense	(8,667,669)				(8,667,669)
Less Securities Lending Expense	(51,330,375)				(51,330,375)
Net Investment Income	2,063,878,767	28,919	6,722,080	(3,413,537)	2,067,216,229
Total Additions	2,768,457,100	28,919	183,392,880	1,608,600	2,953,487,499
DEDUCTIONS					
Benefits	1,102,538,879	32,691		4,245,000	1,106,816,570
Refunds of Contributions	14,822,827		5,834		14,828,661
Insurance Expenses			174,229,097		174,229,097
Administrative Expense	7,351,846				7,351,846
Total Deductions	1,124,713,552	32,691	174,234,931	4,245,000	1,303,226,174
Net Increase (Decrease)	1,643,743,548	(3,772)	9,157,949	(2,636,400)	1,650,261,325
NET ASSETS HELD IN TRUST FOR PENSION AND OTHER POSTEMPLOYMENT BENEFITS:					
Beginning of year	13,778,846,548	515,803	131,614,285	72,564,863	13,983,541,499
Ending of year	$ 15,422,590,096	$ 512,031	$ 140,772,234	$ 69,928,463	$ 15,633,802,824

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements
Years Ended June 30, 2008 and 2007

Note 1: Description of Plan

A. REPORTING ENTITY

The Teachers' Retirement System of the State of Kentucky (KTRS) was created by the 1938 General Assembly and is governed by Chapter 161 Section 220 through Chapter 161 Section 990 of the Kentucky Revised Statutes (KRS). KTRS is a blended component unit of the Commonwealth of Kentucky and therefore is included in the Commonwealth's financial statements. KTRS is a cost-sharing multiple-employer defined benefit plan established to provide pension benefit plan coverage for local school districts and other public educational agencies in the state.

B. PARTICIPANTS

As of June 30, 2008 a total of 199 employers participated in the plan. Employers are comprised of 175 local school districts, 18 Department of Education Agencies and other educational organizations, 5 universities and also the Kentucky Community and Technical College System.

According to KRS 161.220 " . . . any regular or special teacher, or professional occupying a position requiring certification or graduation from a four (4) year college or university . . . " is eligible to participate in the System. The following illustrates the classifications of members:

	2008	2007
Active contributing members:		
Vested	42,932	42,300
Non-vested	32,607	32,844
Inactive members, vested	4,861	4,498
Retirees and beneficiaries currently receiving benefits	40,739	39,506
Total members, retirees, and beneficiaries	**121,139**	**119,148**

C. BENEFIT PROVISIONS

Members become vested when they complete five (5) years of credited service. To qualify for monthly retirement benefits, payable for life, members must either:

1.) Attain age fifty-five (55) and complete five (5) years of Kentucky service, or

2.) Complete 27 years of Kentucky service.

Note 1: Description of Plan continued . . .

Participants that retire before age 60 with less than 27 years of service receive reduced retirement benefits. Non-university members receive monthly payments equal to two (2) percent (service prior to July 1, 1983) and two and one-half (2.5) percent (service after July 1, 1983) of their final average salaries for each year of credited service. University employees receive monthly benefits equal to two (2) percent of their final average salary for each year of credited service. The final average salary is the member's five (5) highest annual salaries except members at least 55 with 27 or more years of service may use their (3) three highest annual salaries. New members (including second retirement accounts started) after July 1, 2002 will receive monthly benefits equal to 2% of their final average salary for each year of service if, upon retirement, their total service is less than ten years. New members after July 1, 2002 who retire with ten or more years of total service will receive monthly benefits equal to 2.5% of their final average salary for each year of service, including the first ten years. In addition, non-university members who retire July 1, 2004 and later with more than 30 years of service will have their multiplier increased for all years over 30 from 2.5% to 3.0% to be used in their benefit calculation

The System also provides disability benefits for vested members at the rate of sixty (60) percent of the final average salary. A life insurance benefit, payable upon the death of a member, is $2,000 for active contributing members and $5,000 for retired or disabled members.

Cost of living increases are one and one-half (1.5) percent annually. Additional ad hoc increases, and any other benefit amendments must be authorized by the General Assembly.

Note 2: Summary of Significant Accounting Policies

A. BASIS OF ACCOUNTING

The financial statements are prepared on the accrual basis of accounting. Member contributions and employer matching are recognized in the fiscal year due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

B. CASH

KTRS has three cash accounts. At June 30, 2008, the pension cash account totaled $5,210,327, the administrative expense fund cash account was $2,873,221, and the life insurance cash account totaled $587,853, therefore, the carrying value of cash was $8,671,401 and the corresponding bank balance was $11,695,507. The variance is primarily due to outstanding checks and items not processed by the bank on June 30, 2008.

C. CAPITAL ASSETS

Fixed assets are recorded at historical cost less straight-line accumulated depreciation. The classes of fixed assets are furniture and equipment, the KTRS office buildings and land. Furniture and equipment are depreciated over an average useful life of five to seven years. The office buildings are depreciated over forty years.

Note 2: Summary of Significant Accounting Policies continued . . .

D. INVESTMENTS

Plan investments are reported at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short-term securities are carried at cost, which approximates fair value. Fixed income and common and preferred stocks are generally valued based on published market prices and quotations from national security exchanges and securities pricing services. Real estate is primarily valued based on appraisals performed by independent appraisers.

Purchase and sales of debt securities, equity securities, and short-term investments are recorded on the trade date. Real estate equity transactions are recorded on the settlement date. Upon sale of investments, the difference between sales proceeds and cost is reflected in the statement of changes in plan net assets.

Investment expenses consist of investment manager and consultant fees along with fees for custodial services.

E. COMPENSATED ABSENCES

Expenses for accumulated vacation days and compensatory time earned by the System's employees are recorded when earned. Upon termination or retirement, employees of the System are paid for accumulated vacation time limited to 450 hours and accumulated compensatory time limited to 200 hours. As of June 30, 2008 and 2007 accrued compensated absences were $658,434 and $636,201.

F. RISK MANAGEMENT

Destruction of assets, theft, employee injuries and court challenges to administrative policy are among the various risks to which the System is exposed. In order to cover such risks the System carries appropriate insurance policies such as fire and tornado, employee bonds, fiduciary liability, worker's compensation and equipment insurance.

G. OTHER RECEIVABLES

KTRS allows qualified purchases of service credit to be made by installment payments not to exceed a five-year period. Revenue is recognized in the initial year of the installment contract agreement. The June 30, 2008 and 2007 installment contract receivables were $661,499 and $777,938.

H. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

I. INCOME TAXES

The defined benefit plan is organized as a tax-exempt retirement plan under the Internal Revenue Code. The tax sheltered annuity plan is no longer continued and will be fully terminated when all lifetime annuities have expired. The System's management believes that it has operated the plans within the constraints imposed by federal tax law.

Note 2: Summary of Significant Accounting Policies continued . . .

J. ACCOUNTING CHANGES

The System early implemented GASB #50 Pension Disclosures last year.

K. RECLASSIFICATIONS

Certain 2007 amounts have been reclassified in conformity with the 2008 presentation.

Note 3: Contributions and Reserves

A. CONTRIBUTIONS

Contribution rates are established by Kentucky Revised Statutes. Members are required to contribute 9.855% of their salaries to the System. University members are required to contribute 8.375% of their salaries. KRS 161.580 allows each university to reduce the contribution of its members by 2.215%; therefore, university members contribute 6.16% of their salary to KTRS.

The Commonwealth of Kentucky is required to contribute 13.105% of salaries for its non-university members and 13.84% of salaries for university members.

The member and employer contributions consist of pension contributions and post-retirement contributions to the medical insurance fund. The post-retirement contribution of .75% from employee and employer contribution rates help finance KTRS' retiree medical insurance plan.

If an employee leaves covered employment before accumulating five (5) years of credited service, accumulated employee contributions plus interest are refunded to the employee upon the member's request.

B. RESERVES

Member Reserve

This fund was established by KRS 161.420(2) as the Teacher Savings Fund and consists of contributions paid by university and non-university members. The fund also includes interest authorized by the Board of Trustees from Unallocated Reserves. The accumulated contributions of members that are returned upon withdrawal or paid to the estate or designated beneficiary in the event of death are paid from this fund. Upon retirement, the member's contributions and the matching state contributions are transferred from this fund to Benefit Reserves, the fund from which retirement benefits are paid.

Employer Reserve

This fund was established by KRS 161.420(3) as the State Accumulation Fund and receives state appropriations to the Retirement System. The state matches an amount equal to members' contributions. State appropriations during the year are based on estimates of

Note 3: Contributions and Reserves continued . . .

members' salaries. At year-end when actual salaries are known, the required state matching is also realized by producing either a receivable from or a payable to the State of Kentucky. While fiscal years 2008 and 2007 resulted in over-appropriations from the state, a receivable is still due from the state because prior years under-appropriations have not been paid to KTRS.

Benefit Reserve

This fund was established by KRS 161.420(4) as the Allowance Reserve Fund, the source for retirement, disability, and survivor benefits paid to members of the System. These benefits are paid from the retired members' contributions until they are exhausted, at which time state matching contributions are used to pay the benefits. After an individual member's contributions and the state matching contributions have been exhausted, retirement benefits are paid from monies transferred from Unallocated Reserves.

Unallocated Reserve

This fund was established by KRS 161.420(4) as the Allowance Reserve Fund, the source for retirement, disability, and survivor benefits paid to members of the System. These benefits are paid from the retired members' contributions until they are exhausted, at which time state matching contributions are used to pay the benefits. After an individual member's contributions and the state matching contributions have been exhausted, retirement benefits are paid from monies transferred from Unallocated Reserves.

Administrative Expense Reserve

This fund was established by KRS 161.420(1) as the Expense Fund. Investment income transferred to this fund from Unallocated Reserves is used to pay the administrative expenses of the System.

Note 4: Funded Status and Funding Progress

A. Description of Funding Progress

The funded status of the Defined Benefit Plan as of the most recent actuarial valuation date is as follows:

(Dollar amount in 1000's)

Valuation Year June 30	Actuarial Value of Assets	Actuarial Accrued Liabilities	Unfunded Actuarial Accrued Liabilities (uaal)	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll
	A	B	B-A	(A/B)	C	[(B-A)/C]
2008	$ 15,321,325	$ 22,460,304	$ 7,138,979	68.2%	$ 3,190,332	223.8%

Note 4: Funded Status and Funding Progress continued . . .

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear funding trend information as obtained from the System's independent actuary's annual valuation report.

Expressing the actuarial value of assets as a percentage of the actuarial accrued liabilities provides an indication whether the System is becoming financially stronger or weaker. Generally, the greater the percentage the stronger the retirement system. Trends in unfunded actuarial accrued liabilities and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liabilities as a percentage of annual covered payroll aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage the stronger the retirement system.

The accompanying schedule of employer contributions, presented as required supplementary information following the notes to the financial statements, presents trend information about the amounts contributed to the plan by employers in comparison to the Annual Required Contribution (ARC). The ARC is actuarially determined in accordance with the parameters of GASB Statement 50. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

B. Methodologies

The promised benefits of the System are included in the actuarially calculated contribution rates, which are developed using the projected unit credit actuarial cost method. Gains and losses are reflected in the unfunded accrued liability that is being amortized by regular annual contributions as a level percentage of payroll within a 30-year period using an open amortization approach. The five (5) year smoothed market approach is used for asset valuation.

Note 4: Funded Status and Funding Progress continued . . .

Actuarial Value Assets

(1)	Actuarial Value of Assets on June 30, 2007	$ 15,286,452,192
(2)	Market Value End of Year June 30, 2008	14,076,692,181
(3)	Market Value Beginning of Year June 30, 2007	15,422,590,096
(4)	Cash Flow	
	a. Contributions	757,671,730
	b. Benefit Payments	1,186,934,184
	c. Administrative Expenses	7,551,936
	d. Net	(436,814,390)
(5)	Investment Income	
	a. Market total: (2) - (3) - (4)c	(909,083,525)
	b. Assumed Rate	7.5%
	c. Amount for Immediate Recognition: [(1) x (5)b] + [(4)c * (5)b * 0.5]	1,140,313,718
	d. Amount for Phased-In Recognition: (5)a - (5)c	(2,049,397,243)
(6)	Phased-In Recognition of Investment Income	
	a. Current Year: 0.20*(5)d	(409,879,449)
	b. First Prior Year	190,240,386
	c. Second Prior Year	(75,996,339)
	d. Third Prior Year	(23,843,540)
	e. Fourth Prior Year	(349,147,545)
	f. Total Recognized Investment Gain	(668,626,487)
(7)	Actuarial Value End of Year (1) + (4)c + (5)c + (6)f	15,321,325,033
(8)	Difference Between Market & Actuarial Values (2) - (7)	$ **(1,244,632,852)**

C. Assumptions

Significant actuarial assumptions employed by the actuary for the funding purposes as of June 30, 2008, the most recent updated actuarial information include:

*	Assumed inflation rate	4%
*	Assumed investment rate	7.5%
*	Assumed projected salary increases	4.0% - 8.20%
*	Assumed post retirement benefit increase	1.5%

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements)

A. LEGAL PROVISIONS FOR INVESTMENTS

The following disclosures are meant to help the users of KTRS' financial statements assess the risks KTRS takes in investing member funds. The Board of Trustees and the Investment Committee are guided by asset allocation parameters that the Board approves through its powers as defined in KRS 161.430. The parameters as outlined in Title 102, Chapter 1.175, Section 2 of the Kentucky Administrative Regulations are as follows:

- There shall be no limit on the amount of investments owned by the System if the investments are guaranteed by the U.S. Government.
- Not more than thirty-five percent (35%) of the assets of the System at market value shall be invested in corporate debt obligations.
- Not more than sixty-five percent (65%) of the assets of the System at market value shall be invested in common stocks or preferred stocks. Not more than twenty-five percent (25%) of the assets of the System at market value shall be invested in a stock portfolio designed to replicate a general stock index. Not more than fifteen percent (15%) of the assets of the System at market value shall be invested in the stocks of companies domiciled outside of the United States; any amounts so invested shall be included in the sixty-five percent (65%) limitation for total stocks.
- Not more than ten percent (10%) of the assets of the System at market value shall be invested in real estate. This would include real estate equity, real estate lease agreements, and shares in real estate investment trusts.
- Not more than ten percent (10%) of the assets of the System at market value shall be invested in alternative investments. This would include private equity, venture capital, timberland, and infrastructure investments.
- Not more than ten percent (10%) of the assets of the System at market value shall be invested in any additional category or categories of investments. The Board of Trustees shall approve by resolution such additional category or categories of investments.

B. CASH AND CASH EQUIVALENTS

For cash deposits and cash equivalents, custodial credit risk is the risk that, in the event of a bank failure, the retirement system's deposits may not be returned to the System. The bank's total balance at June 30, 2008 was $11,695,507 of which $6,237,715 primarily represents deposited amounts due the System for which actual funds are in transit to and waiting to be received by the custodial bank; therefore, these funds were unavailable for

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

investment. An additional amount of $2,873,221 represents funds held in the bank but their investment is controlled by the Commonwealth of Kentucky. There were various outstanding checks and vouchers totaling a $3,023,982 balance reduction while the amount of $2,584,571 was the amount invested in cash equivalents. Cash equivalents are created through the daily sweeps of available excess cash by the System's custodial bank into bank sponsored short-term investment funds. These funds are custodial bank sponsored commingled funds which are invested in short-term securities backed by the U.S. Government and its agencies. The actual cash deposits held in bank accounts were insured up to $100,000 (currently $250,000) as covered by federal depository insurance and uncollateralized until being invested in cash equivalents.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

a. uncollateralized,
b. collateralized with securities held by the pledging financial institution, or
c. collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

As of June 30, 2008, the System's cash equivalents in the amount of $2,584,571 were not exposed to custodial credit risk since this amount was invested by the custodial bank and collateralized at 102% with the collateral pledged to the Treasurer of the Commonwealth of Kentucky.

C. INVESTMENTS

All of the System's assets are invested in short-term and long-term debt (bonds and mortgages) securities, equity (stock) securities, real estate and alternative investments. These assets are reported at fair market value.

Investments are governed by the Board of Trustees' policy while the Board of Trustees and the Investment Committee shall execute their fiduciary responsibilities in accordance with the "prudent person rule", as identified in KRS 161.430 (2)(b). The prudent person rule establishes a standard for all fiduciaries, to act as a prudent person would be expected to act, with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims".

The following chart represents the fair market values of the investments of the Kentucky Teachers' Retirement System for June 30, 2008.

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

Schedule of Investments

	Market Value June 30, 2008	Market Value June 30, 2007
Short Term Investments		
Repurchase Agreements	$ 338,900,000	$ 264,900,000
Agency & Other (Short Term)	49,872,500	301,557,885
Total Short Term Investments	**388,772,500**	**566,457,885**
Bonds and Mortgages		
U. S. Government	924,161,362	1,072,697,874
Agency Bonds	495,014,012	704,207,195
Mortgage-Backed Securities	500,140,653	432,477,395
Collateralized Mortgage Obligations	160,154,576	141,712,059
Asset Backed Securities	155,645,158	180,985,677
Commercial Mortgage-Backed Securities	205,815,754	185,842,508
Municipal Bonds	329,621,169	252,336,753
Corporate Bonds	1,508,621,584	1,499,947,566
Total Bonds and Mortgages	**4,279,174,268**	**4,470,207,027**
Equities		
International Equity	1,328,489,089	1,039,416,148
U. S. Equity	7,700,891,752	9,075,203,866
Total Equities	**9,029,380,841**	**10,114,620,014**
Real Estate		
Real Estate Equity	431,693,774	381,693,796
Total Real Estate Equity	**431,693,774**	**381,693,796**
Alternative Investments		
Private Equity	28,791,613	5,074,147
Timberland	75,995,962	0
Total Alternative Investments	**104,787,575**	**5,074,147**
TOTAL INVESTMENTS	**$ 14,233,808,958**	**$ 15,538,052,869**

This schedule does not include $240,638,736 securities lending collateral.

Custodial Credit Risk

Custodial Credit Risk for an investment is the risk that, in the event of the failure of counterparty, the pension trust fund will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the retirement system, and are held by either:

a. the counterparty or

b. the counterparty's trust department or agent, but not in the System's name.

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

The cash reserve of the System is maintained in high quality short term investments. Commercial paper, U.S. Treasury and agency obligations, certificates of deposit, banker's acceptances, and repurchase agreements are all permissible investments. The System utilized investment instruments it regards as the most secure and having the best returns and does not use short term investments that finance foreign businesses unless they are issued and guaranteed by the United States Government.

Individual repurchase agreements are ordered by KTRS under the terms of Master Repurchase Agreements with various brokers under terms dictated by KTRS. The repurchase agreements and their supporting collateral are held by the custodial agent's correspondent bank in an account identified by the custodian's name and KTRS' nominee name. This account is unique to KTRS. The Master Repurchase Agreements require that the supporting collateral have a market value of at least 102% of the value of the repurchase agreements.

In addition to the System's $14.2 billion in investments at June 30, 2008, cash collateral reinvestment securities acquired through securities lending by the System's custodian, who is also the lending agent/counterparty, amounted to $240,638,736. This is consistent with the System's securities lending agreement with the custodian. (Please refer to a following section entitled Securities Lending.)

Interest Rate Risk

Interest rate risk on investments is the possibility that changes in interest rates will reduce the fair value of the retirement System's investments. In general, the longer the period until an investment matures, the greater the negative impact that changes in interest rates can have on fair value.

As of June 30, 2008 KTRS had the following investments and weighted average maturities:

Investment Type	Fair Value	Average Maturity (years)
U.S. Government	$ 924,161,362	10.4
Agency	495,014,012	9.2
MBS	500,140,653	17.8
CMO	160,154,576	21.0
ABS	155,645,158	8.9
CMBS	205,815,754	29.6
Muni	329,621,169	12.9
Corporate	1,508,621,584	8.6
Totals	**$ 4,279,174,268**	**12.0**

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

In addition to the above securities, Repurchase Agreements (short-term investments) had a total fair value of $388,772,500 of which Repurchase Agreements had a weighted average maturity of 2 days and other Short-term notes/bonds (Discount Notes) had an average maturity of 42 days. Average maturity is used as a measure of a security's exposure to interest rate risk due to fluctuations in market interest rates. Mortgage-backed securities and collateralized mortgage obligations are typically amortizing investments with an average life and interest rate risk significantly less than suggested by the legal maturity. Mortgage-backed securities, which are generally pre-payable, and other callable bonds are subject to adverse changes in average life in response to market interest rate changes. The schedule above reflects only the legal maturity of all such bonds.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. This risk is managed by using the effective duration or option adjusted methodology. It is widely used in the management of fixed income portfolios by quantifying the risk of interest rate changes. This methodology takes into account optionality on bonds and scales the risk of price changes on bonds depending upon the degree of change in rates and the slope of the yield curve. The control of interest rate risk is not set forth in a particular policy; however, the System manages interest rate risk in practice by establishing appropriate benchmarks for its various portfolios.

Mortgage-backed securities are securities representing pass-through interests in the cash flows from pools of mortgage loans on single-family or multi-family residential properties. All of the mortgage-backed securities owned by the System were securitized and are guaranteed by Fannie Mae, Freddie Mac, or GNMA. The average life of a mortgage-backed securities depends upon the level of prepayments experienced in the underlying pool of loans. Market interest rates are a primary determinant of prepayment levels. Lower than anticipated market rates generally lead to higher than anticipated prepayments and a shorter average life; higher than anticipated market rates generally lead to lower than anticipated prepayments and a longer average life. The System held $500.1 million in mortgage-backed securities as of June 30, 2008.

Collateralized mortgage obligations are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes in accordance with a collateralized mortgage obligations established payment order. The System held $160.2 million in collateralized mortgage obligations as of June 30, 2008.

Asset-backed securities are bonds or notes backed by loan paper or accounts receivable originated by banks, credit card companies, or other credit providers. The originator of the loan or accounts receivable paper sells it to a specially created trust, which repackages it as securities. Asset-backed securities have been structured as pass-throughs and as structures with multiple bond classes. The asset-backed securities in the amount of $155.6 million held by the System are moderately sensitive to changes in interest rates.

Commercial mortgage-backed securities are securities representing interests in the cash flows from pools of mortgage loans on commercial properties. The interests in a securitized pool of loans are generally divided into various tranches based upon planned payment order and level of seniority. The System's commercial mortgage-backed securities investments

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

consist of highly rated relatively senior tranches. The average maturity of the System's commercial mortgage-backed securities holdings in the schedule above reflects the legal maturity of those holdings. Most of the tranches held are earlier in the planned payment order than the legal maturity suggests. The System held $205.8 million in commercial mortgage-backed securities investments as of June 30, 2008.

Credit Risk

Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. The following schedule lists KTRS's fixed income investments (net of cash equivalents) according to credit ratings as of June 30, 2008:

RATING	FAIR VALUE	%
U.S. Government	$ 924,161,362	21.6
Agency	495,014,012	11.6
AAA	1,296,983,511	30.3
AA	515,293,078	12.0
A	667,521,214	15.6
BBB	370,644,571	8.7
BB	6,116,520	0.1
B	3,440,000	0.1
Total	$ 4,279,174,268	100.0

Total market value of the fixed income portfolio was $4,279,174,268 on June 30, 2008. The rating system used in the chart is the nationally recognized Standard & Poor's rating system.

In addition to the above categories, the System held $388,772,500 in Cash Equivalents or short term investments such as Repurchase Agreements and Agency Discount Note securities. The credit risk associated with Repurchase Agreements and Agency Discount investments is very minimal as the general rating of these securities is higher than AAA. In addition, investments in US Government and Agency securities are also highly rated securities since they are backed by the US Government. Notation is made that the ratings of securities is subject to change due to circumstances and thereby may have a lower rating than when first purchased.

The System's policy on credit rating as stated in 102 KAR 1:175 is that:

"A fixed income investment shall be rated at the time of purchase within the four (4) highest credit classifications identified by one (1) of the major rating services. A private placement debt investment shall be subject to the same credit qualifications as each fixed income investment. Notwithstanding the foregoing, the fixed income investment portfolio as a whole shall maintain an average rating equal to at least the second highest credit classification."

Note 5: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Losses from credit risk are heightened if a significant portion of resources are invested with a single issuer. Per Administrative Regulation 102 KAR 1:175, the System is subject to the following policies regarding single issuers of fixed income and equity securities:

> "Unless the issuer is the United States Government or a government sponsored enterprise (GSE), the amount invested in the securities of a single issuer shall not equal more than five (5) percent of the assets of the System.
>
> "The System's position in a single stock shall not exceed two and one-half (2.5) percent of the System's assets. The System's position in a single stock shall not exceed five (5) percent of the outstanding stock for that company unless the investment is part of a venture capital program."

KTRS has not invested greater than five percent (5%) of the System's assets at book value in any single issuer and is in compliance with the System's policies as stated here.

Foreign Currency Risk

As of June 30, 2008, KTRS exposure to foreign currency risk consisted of $770,959,026 of foreign equity investments through commingled funds managed by UBS Global Asset Management, Baring Asset Management, and Baillie Gifford as follows:

UBS Global Asset Management	$ 488,863,416
Baring Asset Management	143,997,345
Baillie Gifford	138,098,265
Total	$ 770,959,026

These amounts represent the market values of equities held by the Fund as a result of cash contributions to each Fund by KTRS.

In addition to the commingled funds investing in foreign securities, KTRS held $557,530,063 associated with foreign interests in American Depositary Receipt (ADR) investments. These ADRs are securities that are issued by a U.S. bank in place of the foreign stock shares held in trust by that bank, thereby facilitating the trading of foreign shares in U.S. markets. ADRs are denominated in U.S. currency.

The System's policy regarding foreign equities is that not more than fifteen percent (15%) of the assets of the System at market value shall be invested in the stocks of companies domiciled outside of the United States. Any amounts so invested shall be included in the sixty-five percent (65%) limitation for total stocks per 102 KAR 1:175 Section 2(e).

D. SECURITIES LENDING

Section 161.430 of the Kentucky Revised Statutes empowers the Board of Trustees with complete fiduciary responsibility for the funds of the System. The System operates a securities lending program in which it temporarily lends securities to qualified agents in exchange for a net fee and high quality collateral. U.S. Government and agency securities, selected domestic bonds, and domestic and international (ADR) stocks are the types of securities that are lent. The System's sub-custodian, The Bank of New York Mellon, acts as lending agent in exchanging securities for collateral. The collateral has a value of not less than 102% of the market value of the lent securities plus any accrued, unpaid distributions. The collateral may consist of cash, marketable U.S. Government securities, and select marketable U.S. Government agency securities approved by the System.

Securities lending transactions are accounted for in accordance with GASB Statement No. 28 Accounting and Financial Reporting for Securities Lending Transactions, which established standards of accounting and financial reporting for securities lending transactions. The following section details the net income earned from securities lending for the fiscal year ended June 30, 2008:

Item	Earnings
Gross Earnings (Interest and fees)	$ 21,398,858
Less: Gross Borrower Rebates	19,301,308
Bank Fees	625,544
Net Earnings	$ 1,472,006

Cash collateral is invested in short-term obligations fully guaranteed by the United States Government or select Government agencies and Government Repurchase Agreements with qualified agents. The System cannot pledge or sell collateral securities received unless the borrower defaults. The lending agent (Bank of New York Mellon) also indemnifies the System from any financial loss associated with a borrower's default and collateral inadequacy. As of June 30, 2008 the loan average days to maturity was one (1) day and the weighted average investment maturity of cash collateral investments was one (1) day.

At fiscal year end, the System has no credit risk exposure to borrowers, since the amounts the System owes the borrowers exceeds the amounts the borrowers owe the System and there were no losses resulting during the period.

Security lending programs can entail interest rate risk and credit risk. The System minimizes interest rate risk by limiting the term of cash collateral investments to several days. The credit risk is controlled by investing cash collateral in securities with qualities similar to the credit worthiness of lent securities.

The following table presents the fair values of the underlying securities, and the value of the collateral pledged at June 30, 2008:

Type of Security Lent	Fair Value	Cash Collateral Received Non-cash Collateral Value*
U.S. Government and Agencies	$ 22,871,899	$ 23,269,578
U.S. Equities	209,961,719	217,369,158
Total	$ 232,833,618	$ 240,638,736

* *Represents value of cash collateral only. Loan or margin collateral requirements met via the use of non-cash collateral (e.g. Government securities or Letters of Credit) are excluded from these values.*

Note 6: Pension Plan for Employees of the System

Full-time employees of Kentucky Teachers' Retirement System (KTRS) participate in either KTRS or Kentucky Employees Retirement System. Both plans are multiple-employer cost sharing defined benefit pension plans. All KTRS employees in positions requiring a four-year degree are covered under KTRS. The contribution rates and required employer matching are the same as state agency employers in the System. These rates, the plan description and funding policy are fully disclosed in the notes to the financial statements.

The System's annual required contributions for KTRS employee members for the fiscal years 2008, 2007 and 2006 were $413,492, $388,973, and $368,662 respectively. KTRS contributed 100% of the required contribution each year.

All other KTRS employees are covered under the Kentucky Employee Retirement System (KERS) in the Non-Hazardous Employees Pension Plan. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Per KRS 61.565(3), contribution rates shall be determined by the Board on the basis of an annual actuarial valuation. Rates may be amended by the Board as needed. The System's administrative budget and employer contribution rates are subject to the approval of the Kentucky General Assembly. Employee contribution rates are set by the statute and may be changed only by the Kentucky General Assembly.

Members of KERS were required to contribute 5% of their annual creditable compensation for the fiscal years 2008, 2007, and 2006. As the employer, KTRS is required to contribute the annual actuarially determined rate of the creditable compensation (or the rate approved by legislators). The approved rate for the fiscal years 2008, 2007 and 2006 were 8.5%, 7.75% and 5.89%; and the System's annual required contributions to KERS were $542,848, $114,711 and $103,137 respectively. KTRS contributed 100% of the required contributions for each year.

KERS issues a publicly available financial report that may be obtained by writing Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124.

Note 7: 403(b) Tax-Sheltered Annuity Plan

A. PLAN DESCRIPTION

KTRS has, in prior years, administered a salary deferral program as permitted by section 403(b) of the Internal Revenue Code. Under this program members were able to voluntarily defer a portion of their compensation within the limits established by the applicable laws and regulations. However, the System's Board of Trustees determined that the cost of providing the necessary services to assure the System of continuing compliance with these laws and regulations was not economically feasible due to the limited participation in the program by

Note 7: 403(b) Tax-Sheltered Annuity Plan continued . . .

the System's members. The Board decided, therefore, to discontinue offering the program as of April 30, 1997. Members who were not receiving annuities from their account as of April 30, 1997, were able to transfer their respective accounts directly into other tax-sheltered plans on a tax-free basis. As of June 30, 2008, the twenty-seven members who are receiving annuities will continue to receive distributions according to the terms of their respective elections.

B. SUMMARY OF SIGNIFICANT POLICIES

Basis of Accounting

The Tax-sheltered Annuity Plan financial statements are prepared using an accrual basis of accounting. Contributions are no longer being accepted into the plan, therefore, there are no receivables to be recognized.

Method Used to Value Investments

The short-term investments are reported at cost, which approximates fair value.

Note 8: Medical Insurance Plan & Post-Employment Benefits

A. PLAN DESCRIPTION

In addition to pension benefits described in Note 1, Kentucky Revised Statute 161.675 requires KTRS to provide post-retirement healthcare benefits to eligible members and dependents. The KTRS Medical Insurance benefit is a cost-sharing multiple employer defined benefit plan. Changes made to the medical plan may be made by the KTRS Board of Trustees, the Kentucky Department of Employee Insurance and the General Assembly.

To be eligible for medical benefits, the member must have retired either for service or disability. The KTRS Medical Insurance Fund offers coverage to members under the age of 65 through the Kentucky Employees Health Plan administered by the Kentucky Department of Employee Insurance. KTRS retired members are given a supplement to be used for payment of their health insurance premium. The amount of the member's supplement is based on a contribution supplement table approved by the KTRS Board of Trustees. The retired member pays premiums in excess of the monthly supplement. The Commonwealth of Kentucky bears no risk for excess claims expenses that exceed the premium equivalents charged for the Kentucky Employees Health Plan. Once retired members and eligible spouses attain age 65 and are Medicare eligible, coverage is obtained through the KTRS Medicare Eligible Health Plan. KTRS bears the risk for actual drug claims cost in the Medicare Eligible Health Plan.

At June 30, 2008, KTRS insurance covered 32,164 retirees and 6,585 dependents. There are 199 participating employers and 75,539 active members contributing to the Medical Insurance Fund.

Note 8: Medical Insurance Plan & Post-Employment Benefits continued . . .

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The Medical Insurance Plan financial statements are prepared using the accrual basis of accounting. Member contributions and employer matching are recognized in the fiscal year due.

Healthcare premiums charged to retired members are recognized when due and any premiums collected in advance are recognized as a liability.

Method Used to Value Investments

Since the investments are all short-term investments they are reported at cost, which approximates fair value.

C. CONTRIBUTIONS

The post-retirement healthcare provided by KTRS is financed on a pay-as-you-go basis. In order to fund the post-retirement healthcare benefit, one and five tenths percent (1.5%) of the gross annual payroll of all active members is contributed. One-half (1/2) of this amount is derived from member contributions and one-half (1/2) from state appropriation. Also, the premiums collected from retirees as described in the plan description and investment interest help meet the medical expenses of the plan.

Escalating medical expenses have made it increasingly difficult to meet the expenses of the retiree health insurance program. To further fund the plan, the state legislature has directed a portion of the state employer contribution in a sufficient amount to be allocated to the Medical Insurance Fund instead of the pension fund. The System actuary calculated those amounts to be $85,000,000 and $125,000,000 for fiscal years 2007 and 2008 respectively. Funds allocated to KTRS from the state general fund surplus for the fiscal year ended June 30, 2006 reduced the $85 million allocation to $73 million. The remaining balances are to be amortized over a period of 10 years. The Legislature appropriated $14,133,200 in fiscal year 2007-2008 and $28,487,400 in 2008-2009 to apply to amortization of the balances.

D. FUNDED STATUS AND FUNDING PROGRESS

The funded status of the Medical Insurance Plan as of the most recent actuarial valuation date is as follows:

(Dollar amount in 1000's):

Valuation Year June 30	Actuarial Value of Assets	Actuarial Accrued Liabilities	Unfunded Actuarial Accrued Liabilities (uaal)	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll
	A	B	B-A	(A/B)	C	[(B-A)/C]
2008	$ 185,883	$ 6,434,522	$ 6,248,639	2.9%	$ 3,190,332	195.9%

Note 8: Medical Insurance Plan & Post-Employment Benefits continued . . .

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedules of funding progress, presented as required supplementary information following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The accompanying schedule of employer contributions present trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Significant actuarial methodologies and assumptions employed as of the June 30, 2008 valuation date include the following:

Actuarial cost method	Projected unit credit
Actuarial value of assets	Market value of assets
Assumed inflation rate	4.0%
Investment rate of return	4.5%
Projected salary increases	4.0%
Amortization method	Level percent of pay, open
Remaining amortization period	30 years
Healthcare trend rate	11.00%
Ultimate trend rate	5.00%
Year of Ultimate Pre-Medicare trend rate	2015

E. INCURRED BUT NOT REPORTED CLAIMS LIABILITIES

KTRS recognizes estimates of liabilities for self-insured unpaid claims that have incurred (both reported and unreported) using the development method. This method uses past observed patterns of time between the date the claim is incurred and the date the claim is paid

Note 8: Medical Insurance Plan & Post-Employment Benefits continued . . .

to estimate incurred claims from available paid claim information. The following schedule shows the change in the claims and liability and the claims activity for the years ended June 30, 2008 and 2007.

	Fiscal Year 2008	Fiscal Year 2007
Beginning Unpaid Claims Liability	$ 1,966,148	$ 7,580,738
Current Year Claims and Changes in Estimates	175,915,477	169,502,794
Claims Payments	(175,591,784)	(175,117,384)
Ending Unpaid Claims Liability	$ 2,289,841	$ 1,966,148

Note 9: Life Insurance Plan

A. PLAN DESCRIPTION

The System administers the Life Insurance Plan as provided by KRS 161.655 to provide life insurance benefits to retired and active members. This benefit is financed by actuarially determined contributions from the 199 participating employers. The benefit is $5,000 for members who are retired for service or disability, and $2,000 for active contributing members.

B. SUMMARY OF SIGNIFICANT POLICIES

Basis of Accounting

The Life Insurance Plan financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized in the fiscal year due.

Method Used to Value Investments

Life Insurance Plan investments are reported at fair value. The short-term securities are carried at cost, which approximates fair value. Fixed income is generally valued based on published market prices and quotations from national security exchanges and securities pricing services.

Note 9: Life Insurance Plan continued . . .

C. CONTRIBUTIONS

To finance the life insurance benefit a portion of the employer contribution rate is directed to the plan as recommended by the System's actuary. For fiscal years 2007 and 2008, this rate has been .17% of active members' payroll.

D. FUNDED STATUS AND FUNDING PROGRESS

The funded status of the Life Insurance Plan as of the most recent actuarial valuation date is as follows:

(Dollar amounts in thousands)

Valuation Year June 30	Actuarial Value of Assets	Actuarial Accrued Liabilities	Unfunded Actuarial Accrued Liabilities (uaal)	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll
	A	B	B-A	(A/B)	C	[(B-A)/C]
2008	$ 77,658	$ 84,265	$ 6,607	92.2%	$ 3,190,332	.21%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. The required supplementary schedules following the notes to the financial section contain more actuarial information.

Significant actuarial methodologies and assumptions employed as of the June 30, 2008 valuation date include the following:

Actuarial cost method	Projected unit credit
Actuarial value of assets	Market value of assets
Assumed inflation rate	4.0%
Investment rate of return	7.5%
Projected salary increases	4.0%
Amortization method	Level percent of pay, open
Remaining amortization period	30 years

Note 10: Subsequent Event

Subsequent to the June 30 fiscal year end, the financial markets experienced an unprecedented decline in value. The markets are so dynamic and fluid any judgment of the financial statements must be based on current information rather than fiscal year end. To pick a point in time, as of September 30, the investment portfolio had declined $1.1 billion in value to $13.1 billion, excluding securities lending collateral.

Since June 30, 2008, the financial markets have continued to falter as a result of the

Note 10: Subsequent Event continued . . .

general lack of availability of credit. While the market value of KTRS' investments has been negatively affected by current perceptions of global economic conditions, it is management's view that our long-term time horizon, the diversification of our holdings, and present opportunities to acquire securities at discounts to intrinsic value, position the fund to recover when the economy turns around.

Required Supplementary Schedules

Defined Benefit Plan
Schedule of Funding Progress
(dollar amounts in millions)

VALUATION YEAR JUNE 30	ACTUARIAL VALUE OF ASSETS	ACTUARIAL ACCRUED LIABILITIES	UNFUNDED ACTUARIAL ACCRUED LIABILITIES (UAAL)	FUNDED RATIO	COVERED PAYROLL	UAAL AS A % OF COVERED PAYROLL
	a	**b**	**(b-a)**	**(a/b)**	**c**	**[(b-a)/c]**
2003	$ 13,863.8	$ 16,594.8	$ 2,731.0	83.5%	$ 2,497.7	109.3%
2004	14,255.1	17,617.6	3,362.5	80.8	2,641.5	127.3
2005	14,598.8	19,134.8	4,536.0	76.3	2,703.4	167.8
2006	14,857.6	20,324.7	5,467.1	73.1	2,859.5	191.2
2007	15,285.0	21,255.0	5,970.0	71.9	2,975.3	200.7
2008	15,321.3	22,460.3	7,139.0	68.2	3,190.3	223.8

The amounts reported in this schedule of funding progress do not include assets or liabilities for postemployment benefits, nor are the assets and liabilities of the tax-sheltered annuity plan included.

Required Supplemental Schedule
Defined Benefit Plan
Schedule of Employer Contributions

FISCAL YEAR ENDED JUNE 30	ANNUAL REQUIRED CONTRIBUTIONS	PERCENTAGE CONTRIBUTED
2003	$ 322,046,968	100 %
2004	364,351,412	100
2005	383,776,826	100
2006	406,107,266	100
2007	494,565,369	85
2008	563,789,483	78

Medical Insurance Plan
Schedule of Funding Progress
(dollar amounts in millions)

VALUATION YEAR JUNE 30	ACTUARIAL VALUE OF ASSETS	ACTUARIAL ACCRUED LIABILITIES	UNFUNDED ACTUARIAL ACCRUED LIABILITIES (UAAL)	FUNDED RATIO	COVERED PAYROLL	UAAL AS A % OF COVERED PAYROLL
	a	**b**	**(b-a)**	**(a/b)**	**c**	**[(b-a)/c]**
2003	$ 165.5	$ 2,886.0	$ 2,720.5	5.7%	$ 2,497.7	108.9%
2004	158.9	3,166.6	3,007.7	5.0	2,641.5	113.9
2005	147.3	4,763.9	4,616.6	3.1	2,703.4	170.8
2006	131.6	4,341.9	4,210.3	3.0	2,859.5	147.2
2007	140.8	5,928.8	5,788.0	2.4	2,975.3	194.5
2008	185.9	6,434.5	6,248.6	2.9	3,190.3	195.9

The amounts reported in this schedule of funding progress do not include assets or liabilities for the defined benefit or life insurance plans, nor are the assets and liabilities of the tax-sheltered annuity plan included.

Medical Insurance Plan
Schedule of Employers Contributions

Fiscal Year Ending Date	Annual Required Contribution (ARC) (a)	Actual Employer Contribution (b)	Retiree Drug Subsidy Contribution (c)	Total Contribution (b) + (c)	Percentage of ARC Contributed (b) + (c)
6/30/2007	$231,473,321	$113,258,761	$ 10,312,361	$123,571,122	53.40%
6/30/2008	395,282,164	148,954,644	11,911,565	160,866,209	40.70

Only two years of actuarial calculations of annual required contributions is available.

Life Insurance Plan
Schedule of Funding Progress
(dollar amounts in thousands)

VALUATION YEAR JUNE 30	ACTUARIAL VALUE OF ASSETS	ACTUARIAL ACCRUED LIABILITIES	UNFUNDED ACTUARIAL ACCRUED LIABILITIES (UAAL)	FUNDED RATIO	COVERED PAYROLL	UAAL AS A % OF COVERED PAYROLL
	a	**b**	**(b-a)**	**(a/b)**	**c**	**[(b-a)/c]**
2007	$ 71,426	$ 82,722	$ 11,296	86.3%	$ 2,975,289	0.38%
2008	77,658	84,265	6,607	92.2	3,190,332	0.21

The amounts reported in this schedule of funding progress do not include assets or liabilities for the defined benefit or medical insurance plans, nor are the assets and liabilities of the tax-sheltered annuity plan included.

Life Insurance Plan
Schedule of Employer Contributions

FISCAL YEAR ENDED JUNE 30	ANNUAL REQUIRED CONTRIBUTIONS (ARC)	ACTUAL EMPLOYER CONTRIBUTIONS	PERCENTAGE OF ARC CONTRIBUTED
2007	$ 1,785,173	$ 5,022,137	281.3 %
2008	1,914,199	5,411,249	282.7

Required Supporting Schedules

Supporting Schedule 1

Schedule of Administrative Expenses
Year Ended June 30, 2008

Salaries	$ 5,455,683
Other Personnel Costs	546,347
Professional Services & Contracts	233,841
Utilities	79,592
Rentals	14,852
Maintenance	124,020
Postage & Related Services	311,616
Printing	143,783
Insurance	99,643
Miscellaneous Services	99,936
Telecommunications	27,685
Computer Services	49,344
Computer & Software Maintenance	65,671
Supplies	52,159
Depreciation	107,504
Travel	51,334
Dues & Subscriptions	31,833
Miscellaneous Commodities	11,903
Furniture, Fixtures, & Equipment not Capitalized	22,958
Compensated Absences	22,232
TOTAL ADMINISTRATIVE EXPENSES	**$ 7,551,936**

Schedule of Contracted Investment Management Expenses and Miscellaneous Expenses Year Ended June 30, 2008

BALANCED MANAGER		
Ft. Washington/Todd Investment Advisors		$ 1,375,000
FIXED INCOME MANAGERS		
Galliard Capital Management		478,847
EQUITY MANAGERS		
Baring Focused International	$ 138,412	
GE Asset Management Inc.	800,000	
UBS Global Asset Management Corporation	3,123,278	
Wellington Management Company, LLP	2,598,200	
Total Equity Managers		6,659,890
CUSTODIAN		
Farmers Bank		548,405
CONSULTANT		
Becker, Burke Associates		65,000
OTHER		
Private Equity		330,537
Misc Investment Expenses (noncontracted)		42,153
TOTAL CONTRACTED INVESTMENT MANAGEMENT EXPENSES		$ 9,499,832

Schedule of Professional Fees for Year Ended June 30, 2008

PROFESSIONAL	NATURE OF SERVICE	
Cavanaugh Macdonald Consulting	Actuarial Services	$ 180,835
Charles T. Mitchell Company	Auditing Services	29,600
Farmers Bank	Banking Services	14,314
International Claim Specialist	Investigative Services	3,252
Klausner & Kaufman	Attorney Services	3,050
Reed, Weitkamp, Schell & Vice	Attorney Services	2,790
	TOTAL	**$ 233,841**

William G. Johnson , Jr., C.P.A
James Clouse,C.P.A
Bernadette Smith, C.P.A
Kim Field, C.P.A
Greg Miklavcic, C.P.A
Don C. Giles, C.P.A, Consultant

Charles T. Mitchell Co. LLP
Certified Public Accountants

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Trustees
Teachers' Retirement System of the State of Kentucky
Frankfort, Kentucky

We have audited the financial statements of the Teachers' Retirement System of the State of Kentucky, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2008, and have issued our report thereon dated December 11, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Teachers' Retirement System of the State of Kentucky's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Teachers' Retirement System of the State of Kentucky's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Teachers' Retirement System of the State of Kentucky's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Teachers' Retirement System of the State of Kentucky's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of management and the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Charles T. Mitchell Co.

Frankfort, Kentucky
December 11, 2008

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